

Message Text

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E.O. 11652: GDS
TAGS: EGEN, EG
SUBJ: EGYPT - THE DOMESTIC ECONOMY AND POLITICAL RESTIVE-
- NESS CONSIDERED IN LIGHT OF IMPROVED EXTERNAL
- FINANCES

REF: CAIRO 16196

1. SUMMARY. WE CONCLUDE THAT ECONOMIC CONDITIONS IN EGYPT ARE SUCH, IN LIGHT OF AN OVERALL IMPROVEMENT IN EXTERNAL FINANCES DURING THE PAST YEAR, THAT THE LIKELIHOOD OF SERIOUS DISTURBANCES THREATENING THE POLITICAL SYSTEM FOR SPECIFICALLY ECONOMIC REASONS IS SLIGHTLY LESS THAN IN JANUARY 1977. IT IS CLEAR, HOWEVER, THAT A LARGE SEGMENT OF THE SOCIETY IS ECONOMICALLY DISADVANTAGED, AND KNOWS IT. DISSATISFACTION WITH THEIR LOT COULD BRING THE URBAN POOR OUT INTO THE STREETS AGAIN, A FACT WHICH SERIOUSLY CONCERNS THE GOVERNMENT. ONLY CONTINUED IMPROVEMENT IN THE ECONOMY, WITH THE BENEFITS THEREFROM WIDELY SHARED, WILL SERVE TO ELIMINATE THIS POTENTIAL DANGER. THIS ASSESSMENT DOES NOT TAKE INTO ACCOUNT OTHER STRICTLY POLITICAL FACTORS, SUCH AS CORRUPTION AND THE PEACE PROCESS, WHICH COULD RADICALLY INFLUENCE POLITICAL EVENTS. END SUMMARY
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2. THE REFERENCED MESSAGE REVIEWS EGYPT'S CURRENT MACRO-ECONOMIC POSITION AND NEAR-TERM PROSPECTS, MAINLY WITH RESPECT TO EGYPTIAN RELATIONS WITH FOREIGN DONORS AND CREDITORS. WE NOTE THEREIN THAT THIS ASPECT OF THE EGYPTIAN SCENE IS MUCH IMPROVED OVER THAT OF A YEAR AGO AND THAT DEVELOPMENT QUESTIONS, AS OPPOSED TO U. S. GOVERNMENT

POLITICAL INTERESTS, WILL BEGIN TO ASSUME GREATER IMPORTANCE IN OUR ASSISTANCE PROGRAM. THE MESSAGE POINTS UP, HOWEVER, THE CONTINUED CRITICAL IMPORTANCE TO THE VIABILITY OF THE ECONOMY OF CASH OR PROGRAM (NON-PROJECT) AID FROM DONOR NATIONS INTERESTED IN MAINTAINING THE PROGRESS ALREADY MADE. PARTICULARLY CRUCIAL WILL BE ASSISTANCE FROM ARAB SOURCES OF FUNDING TO PAY FOR IMPORTS, WHETHER FROM THE GULF ORGANIZATION FOR DEVELOPMENT IN EGYPT (GODE) OR ON A BILATERAL BASIS. IF SUCH AID TO THE TUNE OF SOME \$600 MILLION IS NOT FORTHCOMING THIS YEAR, THEN A LARGE PART OF THE GOOD WORK THAT HAS GONE BEFORE, WHICH PERMITS A RELATIVELY OPTIMISTIC APPRAISAL OF THE EGYPTIAN BALANCE OF PAYMENTS AND DEBT SERVICE SITUATION, MAY WELL COME APART WITH A REVERSION BY EGYPT TO EXPENSIVE SHORT-TERM COMMERCIAL CREDIT FACILITIES AND A CONSEQUENT POSSIBILITY OF A RENEWED ARREARS PROBLEM.

3. IN THE PRESENT CABLE WE ADDRESS THE QUESTION OF EGYPT'S ECONOMY IN THE SMALL, I.E., THE CONSEQUENCES OF THE CHANGED ECONOMIC POLICY DIRECTION SINCE 1974 (THE OPEN DOOR) AND OF RELATED FACTORS, TO THE MAN IN THE STREET. WE CONCLUDE THAT THE BENEFITS OF THE OPEN DOOR, AS NOTED BY SADAT HIMSELF, HAVE BEEN UNEQUALLY DISTRIBUTED THROUGHOUT THE EGYPTIAN ECONOMY. LARGE SCALE CAPITALISTS AND PRIVATE ENTREPRENEURS HAVE BENEFITED SIGNIFICANTLY, BUT ONLY A LIMITED AMOUNT OF THESE ADDITIONAL MONIES HAS "TRICKLED
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DOWN" TO THE LARGE MAJORITY, A NOT SURPRISING PHENOMENON AT THIS STAGE. THUS, ALTHOUGH THE ECONOMY IS BEGINNING TO TICK OVER AGAIN IN SOME SECTORS AT A HEIGHTENED PACE, MOST EGYPTIANS REMAIN DESPERATELY POOR BY ANY STANDARD AND OUR BASIC CONCERN ABOUT POLITICAL UNREST CONTINUES.

4. TAKING THE OPEN DOOR IN 1974 AS A STARTING POINT, AS IN THE REFERENCED CABLE, ONE CAN CHART A RISE IN IMPORTS, PRICES, THE COST OF LIVING, CONSUMER SUBSIDY COSTS, POPULATION, BUSINESS ACTIVITY, THE MONEY SUPPLY AND VARIOUS OTHER FACTORS. CERTAIN KEY ELEMENTS OF THE ECONOMY--E.G., WAGES, EXPORTS, HOUSING UNITS STARTED, DISPOSABLE INCOME, FOREIGN PRIVATE INVESTMENT SAVINGS--DID NOT, HOWEVER, SHOW A COMMENSURATE INCREASE. THE WAGE-PRICE SQUEEZE, IN THE WAKE OF WORLD INFLATIONARY PRESSURES OCCASIONED BY THE 1973-74 ENERGY CRISIS, BECAME IN THE FOLLOWING YEARS INCREASINGLY SEVERE ON THE GREAT MAJORITY OF THE EGYPTIAN POPULATION, INCLUDING SENIOR CIVIL SERVANTS AND MILITARY OFFICERS, IN THIS LARGELY PUBLIC SECTOR-ORIENTED ECONOMY. EVEN ADMINISTERED PRICES CREPT INEXORABLY UP, BUT ADMINISTERED WAGES WERE FAR FROM KEEPING PACE. INDEED, GOVERNMENT SALARIES IN MANY INSTANCES

REMAINED UNCHANGED UNTIL VERY RECENTLY.

5. RISING PRICES, COUPLED WITH ENDEMIC HOUSING AND SUPPLY SHORTAGES, ARE UNANIMOUSLY ACCEPTED AS THE PRINCIPAL CAUSES OF WIDESPREAD DISSATISFACTION. OUR ANALYSIS OF THE GOE WAGE AND WHOLESALE PRICE INDICES (ADMITTEDLY SUSPECT STATISTICS) OVER THE PAST TWENTY-EIGHT MONTHS INDICATES THE "AVERAGE" EGYPTIAN IS BEARING AN INCREASINGLY DIFFICULT ECONOMIC BURDEN; FOR EXAMPLE, AT THE TIME OF

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THE JANUARY 1977 RIOTS THE INDEX SPREAD OF WAGES OVER PRICES WAS 31.6 POINTS, WHEREAS IN MARCH 1978 IT WAS DOWN TO 3.5 POINTS. EVEN GOVERNMENT SUPPORTERS SAY THAT IT IS IMPOSSIBLE FOR THE HIGHEST GRADE CIVIL SERVANT TO MAINTAIN HIS STANDARD OF LIVING WITHOUT INDEPENDENT MEANS OR A SECOND INCOME.

6. A MAJOR SAVING GRACE IN THIS POTENTIALLY IMPOSSIBLE SITUATION FOR THE POPULACE WAS THE EXTENT TO WHICH EGYPTIAN CONSUMERS WERE INSULATED DURING THIS PERIOD FROM EXTERNALLY-GENERATED PRICE INCREASES ON MANY OF THE COMMODITIES DEEMED BASIC TO THEIR NEEDS. A PRIME EXAMPLE IS WHEAT: TWO-THIRDS OF EGYPT'S REQUIREMENTS FOR BREAD, AN ABSOLUTELY ESSENTIAL DAILY COMMODITY, IS IMPORTED. THE COMPLICATED SYSTEM OF CONSUMER GOODS SUBSIDIES, RATIONING AND PRICE CONTROLS INSTALLED UNDER NASSER'S SOCIALIST STATE CAME INTO FULL, ALBEIT UNANTICIPATED, PLAY IN 1974. THE COST TO THE GOVERNMENT FOR DIRECT COMMODITY SUBSIDIES ROSE ENORMOUSLY, FROM ABOUT \$225 MILLION IN 1973 TO WELL OVER FOUR TIMES THAT TOTAL IN 1975 (A PARTICULARLY COSTLY YEAR

FOR IMPORTS, TO BE SURE) AND HAS REMAINED ON THAT ORDER OF MAGNITUDE DOWN TO THE PRESENT.

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7. IT IS IMMEDIATELY EVIDENT THAT THIS CONSUMER SUPPORT SYSTEM--WHICH IS STILL IN EFFECT AND WHICH INCLUDES AN ARTIFICIALLY LOW PRICE STRUCTURE ON TRANSPORT, FUELS, CLOTHING AND OTHER ITEMS, IN ADDITION TO "BASIC" GOODS--LED TO THE COUNTRY'S BALANCE OF PAYMENTS AND DEBT SERVICE CRISIS OF 1976-77. BUT THESE MEASURES DID PERMIT THE RETENTION OF PRICES TO THE CONSUMER ON A RANGE OF GOODS FAR BELOW THEIR REAL COSTS; WAGES WERE LOW, BUT PRICES WERE HELD DOWN, AS WELL, IN LINE WITH THE SOCIAL WELFARE PRINCIPLES CARRIED OVER FROM NASSER'S TIMES. THE FAMOUS JANUARY 1977 URBAN RIOTS, IT HARDLY NEEDS TO BE NOTED HERE, RESULTED DIRECTLY FROM AN ILL-ADVISED ATTEMPT ON THE PART OF THE GOVERNMENT TO REDUCE CERTAIN OF THOSE SUBSIDIES (WITH CORRESPONDING PRICE RISES).

8. SINCE THOSE VIOLENT EVENTS SADAT'S GOVERNMENT HAS BEEN, QUITE NATURALLY, EXTREMELY CAREFUL TO AVOID THE APPEARANCE OF A PRECIPITATE REDUCTION IN CONSUMER BENEFITS. DESPITE UPWARD PRICE CREEP IN THE PUBLIC SECTOR (ALTHOUGH NOT GENERALLY TO A COST-RECOVERY LEVEL), AND MORE RAPID RISES IN PRIVATE SECTOR TRADING, THE LID HAS BEEN KEPT ON. THE CHEAPEST LOAF OF BREAD STILL COSTS LESS THAN A PENNY, AS IT HAS FOR MORE THAN 20 YEARS; CAIRO'S (WRETCHEDLY OVERCROWDED) CITY BUSES COST LESS THAN THREE CENTS FOR MANY RUNS, A PRICE UNCHANGED SINCE 1971. OTHER LESS VISIBLE PRICES HAVE BEEN ALLOWED QUIETLY TO RISE IN THE PAST YEAR, AND FURTHER INCREASES ARE IN THE OFFING IN COMPLIANCE WITH UNDERTAKINGS AGREED UPON WITH THE IMF RECENTLY.

9. FACTORS OTHER THAN THE EXISTENCE OF A CUMBERSOME, COSTLY SUBSIDY SYSTEM MAY BE NOTED POSITIVELY IN CONNECTION WITH THE WELFARE OF THE MAN IN THE STREET OVER THE

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PAST YEAR. ALL OF THESE ARE IN THE REALM OF MACROECONOMICS: CONTINUED TIMELY IMPORTS OF NEEDED BASIC COMMODITIES, DUE IN PART TO EGYPT'S PARTIALLY RESTORED CREDITWORTHINESS; INCREASED LIVELINESS IN THE PRIVATE SECTOR, ESPECIALLY IN TRADING; A RISE IN CONSTRUCTION ACTIVITIES; LARGE-SCALE NONCOMMUNIST FOREIGN PROJECT

ASSISTANCE COMING INTO EFFECTIVE PLAY AFTER A GESTATION PERIOD OF A FEW YEARS; AND LAST BUT NOT LEAST, THE MASSIVE TRANSFERS FROM ABROAD OF WORKERS' EARNINGS, BOTH FOR CONSUMPTION AND INVESTMENT. THE ECONOMY, NOTWITHSTANDING SEVERE PROBLEMS, HAS SHOWN AN 8.3 PER CENT REAL GROWTH RATE IN THE LAST YEAR (ALTHOUGH PER CAPITA ANNUAL INCOME IS STILL ONLY ABOUT \$300). THESE DEVELOPMENTS ARE BELIEVED TO SERVE EMPLOYMENT-CREATING, INCOME-GENERATING, PROFIT-MAKING, CONSUMPTION AND RESOURCE-TRANSFER PURPOSES TO SOME EXTENT, ALTHOUGH MUCH OF THE NEWLY-AVAILABLE WEALTH IS GOING INTO REAL ESTATE, NOT THE PRODUCTIVE SECTORS. THE "TRICKE DOWN" EFFECT ON THE COMMON MAN OF THIS HEIGHTENED ACTIVITY IS OF CONSEQUENCE, ALBEIT TO AN UNMEASURED EXTENT, IN QUANTITATIVE TERMS. THERE IS LITTLE DOUBT THAT THE BITTERNESS AND FRUSTRATION OF THE LOWER AND LOWER-MIDDLE CLASSES (THE BULK OF THE URBAN POPULATION) HAVE BEEN INTENSIFIED BY THE DISPLAY OF A WIDE VARIETY OF IMPORTED GOODS IN SHOP WINDOWS AND ON TV, RANGING FROM CANNED SOFT DRINKS TO COSMETICS AND FINE ENGLISH WOOLS, AT PRICES ONLY VISITING ARAB SHEIKHS, FOREIGNERS, AND A SMALL MINORITY OF EGYPTIANS CAN AFFORD. THE PORT SAID FREE ZONE, INSTEAD OF CONTRIBUTING TO INDUSTRIAL DEVELOPMENT, IS WIDELY (AND NOT WHOLLY INACCURATELY) CONSIDERED A SMUGGLERS' PARADISE AND SOURCE OF LUXURY IMPORTS FOR THE WELL-TO-DO. EVEN SADAT SUPPORTERS WHO

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ENJOY THESE PRODUCTS WISH THEY WOULD BE SOLD SURREPTITIOUSLY.

10. ONE RESULT OF THESE CHANGED CONDITIONS, AND OF INCREASINGLY SEVERE PRESSURES ON INCOME LEVELS IN AN

INFLATIONARY PERIOD, HAS BEEN THE INSTITUTION OF LONG-DELAYED WAGE RISES. MEDIUM-LEVEL AND HIGHER CIVIL SERVICE AND PUBLIC SECTOR EMPLOYEES HAVE RECENTLY RECEIVED THEIR FIRST PAY RAISE SINCE 1971, AND THE MILITARY ONLY ITS SECOND, TO OUR KNOWLEDGE, IN ROUGHLY THE SAME PERIOD. OTHER SEGMENTS OF THE SPRAWLING BUREAUCRACY, PENSIONERS AND PRIVATE SECTOR WORKERS ALSO BENEFITTED FROM THE GOVERNMENT'S ACTIONS. THE INCREASES WERE MODEST, HOWEVER, NO MATTER HOW WELCOME THEY UNDOUBTEDLY WERE TO THE RECIPIENTS, AND WAGE LEVELS REMAIN LOW (THE MINIMUM LEGAL WAGE NOW IS THE EQUIVALENT OF \$21.45 PER MONTH; A VERY SENIOR CIVIL SERVANT MAKES \$250 PER MONTH IN BASIC SALARY).

11. NO MATTER HOW MANY RELATIVELY POSITIVE POINTS THAT CAN BE CITED IN REGARD TO THE ECONOMY (AND WE WOULD NOT WANT TO OVERSTATE THE CASE), THE FACT REMAINS THAT THE DISPARITY BETWEEN LOW INCOMES AND RISING LIVING COSTS CONTINUES. NO QUICK SOLUTIONS ARE AVAILABLE TO THE PROBLEMS OF BROADLY-BASED DEVELOPMENT, THE ONLY MEANS BY
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WHICH THE MORE THAN MINIMAL NEED OF EGYPTIANS AT LARGE CAN BE MET OVER THE MEDIUM AND LONGER TERM. GIVEN THE CONTINUED SQUEEZE ON CONSUMPTION, IT IS NO WONDER THAT THE GOVERNMENT'S LEADERS REMAIN FEARFUL OF A RECURRENCE OF JANUARY 1977 AND TAILOR THEIR ECONOMIC (AND SECURITY) PROGRAMS ACCORDINGLY.

12. ONE FURTHER SPECIAL CONSIDERATION SHOULD BE NOTED, ALSO ON THE NEGATIVE SIDE. MUCH HAS BEEN SAID, INCLUDING A COMMENT IN THE REFERENCED MESSAGE, ABOUT THE SAD DETERIORATION OF THE EGYPTIAN INFRASTRUCTURE AS A RESULT OF INSUFFICIENT INVESTMENT OVER THE YEARS EVEN TO MAINTAIN EXISTING FACILITIES. TO THE INDIVIDUAL EGYPTIAN, ESPECIALLY THE URBAN DWELLER, THIS IS NOT A MATTER OF ACADEMIC INTEREST. THE LACK OF HOUSING AND PUBLIC TRANSPORT, THE INADEQUATE EDUCATIONAL, HEALTH AND OTHER GOVERNMENT SERVICES, ARE VEXING TO ALL; GROSSLY INSUFFICIENT TELECOMMUNICATIONS, ROAD AND SANITATION FACILITIES, IN ADDITION TO THE GENERAL STATE OF URBAN DECREPITUDE, ALSO ARE OF CONCERN TO THE EDUCATED ELITE. IT IS NOT ONLY ON A QUANTIFIED BASIS THAT DISSATISFACTIONS SHOULD BE CONSIDERED; THE POOR QUALITY OF PUBLIC SERVICES AND FACILITIES, OR THE NEAR-TOTAL LACK THEREOF, IS AN EQUALLY IMPORTANT NEGATIVE FACTOR AT THIS TIME. WITH THE POPULATION OF EGYPT INCREASING BY ONE MILLION PER YEAR, AND THAT OF CAIRO BY OVER 1,000 PER DAY, THERE IS A MARKED DECLINE IN THE QUALITY OF LIFE FOR ALL. THE GOVERNMENT IS UNABLE TO MAINTAIN THE EXISTING INFRASTRUCTURE, LET ALONE ADD ANY MEANINGFUL IMPROVEMENTS.

13. ON THE POSITIVE SIDE, REMITTANCES FROM ABROAD PROBABLY HAVE PLAYED A PART IN MAKING AVAILABLE INCREASED DISPOSABLE INCOME TO A SIGNIFICANT SEGMENT OF THE POPU-
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LACE, BUT THERE IS LITTLE DATA AVAILABLE ON WHERE THIS MONEY IS GOING; IT IS OUR IMPRESSION, AS NOTED ABOVE, THAT A CONSIDERABLE PORTION OF IT IS GOING TO SPECULATIVE, NONPRODUCTIVE, PURPOSES. WE NOTE FURTHER IN A POSITIVE VEIN, HOWEVER, THE RECENT OVERALL IMPROVEMENT IN THE ECONOMY, THE ATTENTION WHICH THE GOVERNMENT HAS DEVOTED TO SOLVING SUPPLY AND DISTRIBUTION PROBLEMS, AND THE CONSTANT EFFORTS OF THE GOVERNMENT TO PORTRAY ITSELF PUBLICLY AS THE DEFENDER OF LOWER-INCOME CONSUMER INTERESTS. IF A SUBSTANTIAL PERCENTAGE OF THE URBAN POPULATION BELIEVED IT HAS, OR STANDS SOON, TO BENEFIT AT LEAST INDIRECTLY FROM THE FAVORABLE DEVELOPMENTS IN THE OVERALL ECONOMIC PICTURE, THEN THE GOVERNMENT'S PROBLEMS WOULD BE CONSIDERABLY REDUCED IN SIZE. UNFORTUNATELY, THE RESERVOIR OF DISADVANTAGED, DISSATISFIED EGYPTIANS REMAINS LARGE.

14. TO CONCLUDE, THE VITAL QUESTION OF DOMESTIC POLITICAL STABILITY AS A FUNCTION OF INTERNAL ECONOMIC CONDITIONS IS NOT EASY OF ANSWER, EVEN GIVEN COMPLETE CURRENT INFORMATION ON THOSE CONDITIONS (WHICH NEITHER WE NOR ANYONE ELSE HAS). THE GOVERNMENT IS WITHOUT DOUBT CONCERNED ABOUT THE PROBLEM, ALTHOUGH IMF-RELATED REFORMS, NOTABLY IN THE PUBLIC SECTOR PRICING AREA, CONTINUE TO MOVE ALONG--SLOWLY AND CAREFULLY. IN TIME, THE MARKED IMPROVEMENT IN THE NATION'S EXTERNAL ECONOMIC PICTURE, IF CONTINUED, WILL HAVE A POSITIVE EFFECT ON THE AVERAGE EGYPTIAN'S PERCEPTION OF HIS AND HIS FAMILY'S WELL BEING. PRECISELY HOW MUCH OF A POSITIVE EFFECT THIS OVERALL IMPROVEMENT HAS HAD THUS FAR, AND HOW FAR BELOW A FLASH POINT CURRENT PERCEPTIONS ARE NOW, ARE OPEN QUESTIONS. WE

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BELIEVE ON BALANCE, HOWEVER, THAT THE LIKELIHOOD OF MAJOR PUBLIC DISTURBANCES STEMMING DIRECTLY FROM ECONOMIC CONDITIONS OF SUFFICIENT SERIOUSNESS TO THREATEN THE GOVERNMENT IS SLIGHTLY LOWER THAN WAS THE CASE IN JANUARY 1977.

15. THE ABOVE ASSESSMENT DOES NOT, HOWEVER, TAKE INTO ACCOUNT OTHER STRICTLY POLITICAL FACTORS THAT COULD EXACERBATE ECONOMIC DISCONTENT OR CAUSE SERIOUS PUBLIC DISORDERS ON THEIR OWN. ALLEGEDLY WIDESPREAD CORRUPTION, FOR EXAMPLE, REMAINS A CONSTANT SUBJECT OF DISCUSSION AND DISCONTENT AMONG MOST LEVELS OF SOCIETY. THE PEACE PROCESS ALSO DIRECTLY INFLUENCES ECONOMIC AND POLITICAL ATTITUDES. ONE OF EGYPT'S LEADING INTELLECTUALS POINTS OUT THAT THE JANUARY 1977 RIOTS AND THE NOVEMBER 1977 OUTPOURING OF EMOTIONS UPON SADAT'S RETURN FROM JERUSALEM WERE IN FACT MANIFESTATIONS OF THE SAME STRONGLY HELD FEELING AMONG EGYPT'S MASSES, I.E., A DESIRE FOR A BETTER FUTURE. IN THE FIRST INSTANCE THIS FEELING WAS EXPRESSED DESTRUCTIVELY AGAINST HIGHER PRICES; IN THE SECOND, POSITIVELY, BECAUSE THEY EQUATE PEACE WITH PROSPERITY. SHOULD THE PEACE PROCESS APPEAR TO BE COLLAPSING, EGYPTIAN DESPAIR OVER THE FUTURE WOULD NOT BE FAR BEHIND. EILTS
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